



DAWN CLARK NETSCH

Comptroller
State of Illinois

State of Illinois Center
100 West Randolph, Suite 15-500
Chicago, Illinois 60601
312/814-2451

201 State House
Springfield, Illinois 62706
217/782-6000

January 14, 1993

PAYROLL BULLETIN
(1-93)

TO: All State Agencies, Departments, Boards, Commissions
and Universities

SUBJECT: Educational Assistance

Immediate Action Required to Avoid Penalties

As reported in Payroll Bulletin 5-92, President Bush vetoed H.R. 11 on November 4, 1992, causing the exclusion for employer-provided educational assistance to expire on June 30, 1992. Thus, employer-provided educational assistance paid after June 30, 1992, which does not otherwise qualify for tax exclusion (see Determining Taxability), must be reported as taxable income in the year of payment and is subject to income, Social Security and Medicare tax withholding. The employing agency is also responsible for the employer's share of Social Security and Medicare taxes.

In Bulletin 5-92, we provided instructions for withholding income and Social Security/Medicare taxes and noted that withholding for 1992 payments should occur no later than the last payroll for calendar year 1992. It has recently come to our attention that some agencies did not withhold before the end of the year for employer-paid educational assistance (including amounts paid under the State's Upward Mobility Program) due to insufficient time or because they were unaware of their responsibility to do so. Whether paid directly by the agency or through the Upward Mobility Program, agencies are responsible for identifying taxable educational assistance (see Determining Taxability), withholding and reporting taxes, and paying the employer's share of Social Security/Medicare taxes.

If your agency was unable to withhold taxes on taxable educational assistance before the end of the calendar year or was unaware of your responsibility to do so, we advise that you follow the payroll procedures outlined on page 3 of this Bulletin to withhold Social Security/Medicare taxes and correct W-2s. Under federal law, withholding income taxes on 1992 income is not permitted in 1993. However, Social Security and Medicare taxes **MUST** be withheld from the employee's next payroll in order for the Comptroller's Office to deposit the taxes due by January 31, 1993, the due date for the fourth quarter 941 return. Although 1992 income taxes cannot be withheld, the employee's 1992 W-2 **MUST** reflect the additional taxable income. Willful failure to comply with withholding and reporting laws can result in civil and criminal penalties.

Determining Taxability

Educational expenses qualifying as a working condition fringe benefit under Internal Revenue Code (IRC) Section 132(d) or paid under a scholarship or tuition reduction program meeting IRC Section 117 requirements are not taxable.

To qualify as a **working condition fringe benefit**, the education must meet all of the following criteria:

- 1) The course must maintain or improve skills necessary for current employment; or be required for the employee to retain his or her current employment, status, or rate of pay.
- 2) The courses cannot be part of a program that can qualify the employee for a new trade or business, even if the employee does not intend to change occupations.
- 3) The courses cannot enable the individual to meet minimum employment requirements.

For example, the cost of a CPA review course is not excludable because it can lead to a new profession as a CPA. Similarly, the cost of law school or a bar review course is taxable. The cost of courses taken by a licensed practical nurse (LPN) which qualify the employee to become a registered nurse (RN) is taxable because LPNs and RNs are subject to different registration and certification requirements.

If the courses lead to a change of position or promotion within the same occupation, the cost is not taxable if the new duties involve the same general type of work. If the employee is practicing in a profession, the costs of courses leading to a specialty within that profession are not taxable. For example, additional legal education for an attorney is not taxable. Education permitting an elementary teacher to become a secondary school teacher or principal is not taxable because it is considered the same profession. On the other hand, the cost of a college program enabling a teacher's aide to become a teacher is taxable.

Working condition fringe benefits include education expenses that would be deductible by the employee as ordinary and necessary business expenses if not reimbursed by the employer (without regard to the 2 percent floor for miscellaneous itemized deductions). Further information on education expenses which qualify as ordinary and necessary business expenses can be found in IRS Publication 508 **Educational Expenses**. This publication can be obtained at your local IRS office.

Scholarships and fellowships are nontaxable providing:

- 1) The employee is a candidate for a degree; and
- 2) Past, present or future services are not required as a condition for receiving the scholarship or fellowship.

The part of any grant that represents payment for past, present or future services is taxable. Payments for expenses such as room, board and travel are taxable.

A qualified **tuition reduction** program is a full or partial reduction in tuition that is provided by an educational institution to an employee enrolled in study at the employing institution or another educational institution. It applies only to education below the graduate level unless it is for the education of an employee who is a graduate student engaged in teaching or research. To qualify, the tuition reduction cannot be received in lieu of compensation for the employee's services.

Payroll Procedures For Correcting 1992 Income

The following procedures outline the steps required to:

- a) Collect the employee's share of Social Security/Medicare taxes by payroll deduction in January 1993;
- b) Remit the employing agency's share of Social Security/Medicare taxes by completion of a C-13 form; and
- c) Correct the employee's 1992 W-2 to reflect taxable educational assistance.

a) After determining the amount of taxable educational assistance, calculate the amount of Social Security (6.2%) and/or Medicare (1.45%) due. This amount must be deducted from the employee's earnings on the next January payroll. The deduction must appear in field 31 of the payroll voucher, Involuntary Deductions other than Garnishment, and also in tape positions 348 through 354. The Comptroller trailer code will be 10 and the actual code will be 001, 002, etc. The trailer record must be made payable to the Social Security Administration Fund and contain the employee's name and Social Security number as follows:

Social Security Administration Fund
123-45-6789 Doe, John

b) Prepare C-13 Invoice Vouchers for the State's contribution to Social Security and/or Medicare. The voucher should be made payable as follows:

Social Security Administration Fund
c/o Office of the Comptroller
Attention: Dan Steven
325 West Adams
Springfield, Illinois 62704-1858

For the Vendor Number in Box 2 of the C-13 Invoice Voucher, use 100036001. Be sure to include in Box 10 of the voucher, or through an attachment to the remittance copy, the employees for whom the payment pertains.

c) To correct the 1992 W-2, complete Form SCO-050 (attached) as follows:

Column

- 1 Enter the employee's Social Security Number.
- 2 Enter the employee's name: last, first and middle initial.
- 3 Enter the payroll code under which the employee is paid.
- 4 Enter the total taxable education assistance for 1992 that was not reported on a 1992 payroll.
- 5 If the employee is subject to the Social Security portion of the FICA tax, enter 6.2% of the amount in column 4. If the employee is not subject to Social Security, enter N/A.
- 6 If the employee is subject to the Medicare portion of the FICA tax, enter 1.45% of the amount in column 4. If the employee is not subject to Medicare, enter N/A.
- 7 Enter the total of the amounts in columns 5 and 6. This amount should be the same as the deducted amount.
- 8 Enter the total of column 7.

Please remember, even if the employee is not subject to Social Security and/or Medicare, the taxable portion of the educational assistance must still appear in column 4.

Forward the completed SCO-050 to the Comptroller's Office with your payroll voucher. You may duplicate SCO-050 for your use or submit a computer printout in the same format.

The Comptroller's Office, upon receipt of the Form SCO-050, will process the corrected W-2Cs as quickly as possible. Please tell your employees not to call our office about the status of their W-2C. Because of the anticipated volume of these forms, we will be unable to answer individual inquiries.

Retirement Contributions

Retirement contributions (both employee and employer) are also due on the taxable amount of educational assistance provided to employees. In most instances, the employing agency is participating in the employer pickup of employee retirement contributions. The agency should determine the retirement status of each employee and whether contributions are required to be remitted to the State Employees' Retirement System (SERS).

Questions concerning the employees' retirement status should be directed to SERS at 217-785-7192. The agency should prepare a C-13 Invoice Voucher for the State's contribution to SERS and also for the amount of the employer pickup of employee retirement contributions. The voucher should be made payable as follows:

State Employees' Retirement System
Attention: Nick Merrill
P.O. Box 19255
2101 South Veterans Parkway
Springfield, Illinois 62794-9255

For the Vendor Number in Box 2 of the C-13 Invoice Voucher, use 100058901. Be sure to include in Box 10 of the voucher, or through an attachment to the remittance copy, the employees for which the payment pertains.

Notify Employees As Soon As Possible

Please notify the employees in your agency as soon as possible of the amount of their taxable educational assistance and deduction for Social Security/Medicare taxes. Inform them they will receive a corrected W-2 form (W-2C) which will reflect this taxable educational assistance, and that they may have federal and State income taxes due when they file their 1992 tax returns since income taxes will not be withheld.

1993 Payments For Educational Assistance

Educational assistance paid in the 1993 calendar year, not qualifying for the specific tax exclusions described in the Bulletin, is currently taxable. While the Comptroller's Office is working to have the general exclusion for assistance up to \$5250 reinstated, we cannot predict when and if that will happen and if it will be retroactive to January 1, 1993.

In the meantime, agencies must comply with current law and withhold taxes as described in Payroll Bulletin 5-92. We are, however, researching the possibility that 1993 withholding can be spread over multiple payroll periods within the calendar year. A Payroll Bulletin will be issued on this subject at a later date.

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Questions regarding this Payroll Bulletin should be referred to Nancy Smith or Dan Steven at (217) 782-4758.

Note: The purpose of this Bulletin is to provide payroll procedures for reporting taxable educational assistance and to describe generally the tax treatment of payments for educational assistance. Agencies must consult with their local office of the Internal Revenue Service, tax publications, or a professional tax advisor for specific questions about determining the taxability of educational assistance.



**Return Form To:
Office of the Comptroller
State of Illinois
Attention: Dan Steven
325 West Adams Street
Springfield, IL 62704-1858**

Agency _____
Contact Person _____
Telephone _____

[illegible]



DAWN CLARK NETSCH

Comptroller
State of Illinois

201 State House
Springfield, Illinois 62706
217/782-6000
TDD 217/782-1308

State of Illinois Center
100 West Randolph, Suite 15-500
Chicago, Illinois 60601
312/814-2451

January 19, 1993

**TO: All State Agencies, Departments, Boards, Commissions
and Universities**

SUBJECT: Educational Assistance

Correction to Payroll Bulletin 1-93

Due to a typographical error, a line was inadvertently omitted from Page 3 of Bulletin 1-93.

Please remove and replace Page 3 with the corrected page attached. The missing phrase was in the third paragraph which concerns tuition reduction programs provided by educational institutions.

We apologize for any inconvenience or misunderstanding this omission may have caused.

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